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August 4, 2003

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
455 12th Street, S.W.
Washington, D.C. 20554

Re: Notice of Ex Parte Presentation
MB Docket No. 03-124

Dear Ms. Dortch:

Enclosed, pursuant to 47 C.F.R. ¶ 1.1206 (b)(1), please find two copies of "A Further Economic Analysis of the News Corp. Takeover of DirecTV" authored by Professor William P. Rogerson of Northwestern University on behalf of Advance/Newhouse Communications, Cable One, Cox Communications and Insight Communications (the "Joint Cable Commenters").[1] Professor Rogerson's paper responds to the economic submissions[2] proffered by The News Corporation Limited ("News Corp.") and General Motors Corporation/Hughes Electronics Corporation (collectively, the "Applicants") in connection with their Opposition to Petitions to Deny and Reply Comments, filed July 1, 2003 in the above-captioned proceeding ("Opposition").

Everything in Professor Rogerson's Analysis is derivable from the public versions of the Opposition and accompanying affidavits. To reaffirm that conclusion, we provided the public version of the CRA Report, Professor Rogerson's first Affidavit, and a complete draft of the attached Further Economic Analysis to a reputable, independent economist. He was able to replicate, from the public versions, the calculations in this Analysis that refer to the CRA report.

1 Hereinafter "Rogerson."

2 Dennis W. Carlton, Janice H. Halpern and Gustavo E. Bamburger, Lexecon Inc., *Economic Analysis of the News Corporation/DirecTV Transaction*, July 1, 2003 ("Lexecon,") and Steven C. Salop, Carl Shapiro, David Majerus, Serge Moresi, and E. Jane Murdoch, Charles River Associates, *News Corporation's Partial Acquisition of DirecTV: Economic Analysis of Vertical Foreclosure Claims*, July 1, 2003 ("CRA").

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List A B C D E

Background and Summary

Neither the Applicants' Opposition – nor the expert reports attached thereto – ever grapple with the key arguments the Joint Cable Commenters have made. Control of the DirecTV distribution platform effectively reduces the costs and risks to News Corp. of employing "take it or leave it" bargaining tactics with competing MVPDs seeking to carry "must have" FOX broadcast network and regional sports network ("RSN") programming. As Professor Rogerson states in the attached:

> In my initial Affidavit, I concluded that the acquisition of a controlling stake in DirecTV by News Corp. could provide News Corp with both the ability and incentive to raise prices to rival MVPDs for its "must have" programming -- its regional sports networks and its owned-and-operated television broadcast stations. The acquisition of DirecTV will increase News Corp.'s bargaining power and negotiating leverage and will lead to higher prices for consumers, particularly in less dense regions of the country served by small to medium sized cable systems.[3]

Notably, the Applicants and their experts go to great lengths to demonstrate that it would be unprofitable for News Corp. to permanently withhold Fox programming from all competing MVPDs[4] – a scenario not raised by the Joint Cable Commenters. As Professor Rogerson emphasizes, the real threat to consumer welfare posed by this transaction is not permanent forecbsure. To the contrary, News Corp. will be able to raise prices to all consumers because it need only withhold – or threaten to withhold – programming from a handful of MVPDs in a few select markets for only a short period of time in order to obtain undue pricing power and negotiating leverage:

> In large part, the studies of News Corp.'s economists are focused upon demonstrating that it is not economically rational for News Corp to withhold programming permanently from rival MVPDs to increase DirecTV's attractiveness and market share. Lexecon and CRA ignore and do not account for the more likely scenario—that News Corp., armed with increased bargaining power, has increased ability to raise prices to all distributors, and therefore to consumers, through the actual or threatened withholding of programming. Furthermore, Lexecon and CRA ignore the fact that engaging in or threatening to engage in temporary withdrawals of programming during pricing disputes may provide an even more powerful lever for News Corp. than the threat of permanently withdrawing programming.[5]

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3 Rogerson at 2.

4 *See, e.g.*, Opposition at 27, 28, 30, 39, 41.

5 Rogerson at 2.

Notwithstanding the faulty premises on which the Applicants' expert submissions rest, Professor Rogerson notes that those submissions nonetheless provide quantitative validation of the Joint Cable Commenters' principal concern – that the transaction lowers the costs to News Corp. of engaging in bargaining tactics that threaten to yield either higher cable rates and/or more YES-type service interruptions:

> [T]he quantitative exercise that CRA undertook does provide the components that permit me to demonstrate the fundamental point that this merger will increase News Corp.'s ability to bargain with rival MVPDs for higher programming prices. Even for the case of permanent withdrawals considered by CRA, the profits that DirecTV would earn if News Corp. withdrew programming from its rivals would offset a significant share of News Corp's losses. This is sufficient to significantly increase the credibility of News Corp.'s threat to withdraw programming. Furthermore, the CRA math can also be used to calculate the profitability of temporary withdrawals of programming during price disputes. I calculate that if News Corp. temporarily withholds an RSN or a broadcast station from a targeted MPVD, it economically breaks even if less than one percent of the MVPD's subscribers migrate to DirecTV. Once one additionally realizes that the purpose of the temporary withholding of programming would be also, if not primarily, to increase prices across a national base of over ninety million MPVD homes, it becomes clear that, contrary to the parties' economic reports, News Corp. has every incentive to engage in such conduct. [6]

Professor Rogerson's analysis confirms that the pending transaction carries with it a structural threat to consumer welfare that can and must be addressed via targeted conditions. Prior to acquiring a controlling interest in DirecTV, News Corp. faces some risk and uncertainty. It does not know whether the loss of subscription and advertising revenue from a service interruption arising from a temporary bargaining impasse with a cable operator over carriage of RSN or FOX programming could be made up via higher carriage fees gained from that distributor (and others in adjacent markets) once the impasse is resolved.[7] The takeover

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[6] Rogerson at 2-3.

[7] Notwithstanding such risks, News Corp. has, on three occasions in the past two years, deauthorized cable operators from carrying the signal of an RSN that it controls in an effort to obtain higher carriage fees. *See* Comments of Advance/Newhouse Communications, Cable One, Cox Communications and Insight Communications, filed June 16, 2003, at 41-42 ("Comments of Joint Cable Commenters"). Similarly, several cable operators have been subject to – or seriously threatened with – service interruptions due to their resistance to higher fees and additional channel capacity demanded by News Corp. in exchange for retransmission consent of owned and operated Fox broadcast stations. *See id.* at 24-25. Meanwhile, DirecTV repeatedly has taken

substantially reduces, if not eliminates, the pre-transaction risks to News Corp. of failing to conclude a carriage agreement with a cable operator for a "must have" Fox programming service.

With the Fox cable and broadcast services and the DirecTV distribution platform under the same corporate banner, News Corp. can coordinate these formidable content and distribution assets to maximize its leverage during program carriage disputes with cable operators. The transaction substantially lowers the costs of such disputes for News Corp. and thereby increases the likelihood of higher programming costs and/or more frequent carriage disputes. Once it controls DirecTV, News Corp. will pocket additional revenues gained from subscribers who migrate to the DirecTV platform in order not to lose access to the disputed programming. By placing a cable operator in the position of either giving in to higher programming fees for "must have" content, or ceding such content to its chief rival, the transaction creates a structural circumstance in which an adverse impact on consumer welfare – in the form of higher prices or reduced output – is inevitable.

In short, notwithstanding claims to the contrary by the Applicants' economists, Professor Rogerson demonstrates that the DirecTV acquisition provides News Corp. with an increased incentive and ability to extract supra-competitive prices for FOX broadcast and RSN programming from competing MVPDs. As a result, the transaction poses harms to consumers and competition in the absence of conditions reasonably tailored to address these harms.

The following key points merit consideration:

DirecTV's National Footprint – Not Its Share of the MVPD Marketplace – Is the Key Factual Predicate for the Harms Identified by the Joint Cable Commenters. Fundamentally, the Applicants' submissions are structured as though the key competitive concern of this transaction is that News Corp. will seek to benefit DirecTV by denying its competitors access to Fox programming.[8] Thus, the Applicants point to DirecTV's thirteen

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advantage of retransmission consent and RSN carriage disputes to recruit cable subscribers disaffected by the loss (or potential loss) of programming on cable systems resisting programmer demands for higher fees and additional channel capacity. *See, e.g.,* Ken Kerschbaumer, *Cablevision Finally Says YES*, Broadcasting and Cable, March 17, 2003, at 2 (discussing DirecTV campaign to convince Yankees fans to drop Cablevision over YES carriage dispute); Monica Hogan, *Time Warner Houston Thwarts DBS Attacks*, Multichannel News, June 24, 2002, at 30 (discussing $6 million campaign aimed at convincing Time Warner subscribers to switch to DBS during ABC blackout resulting from retransmission consent dispute).

[8] *See, e.g.*, Opposition at 12 (framing argument in terms of vertical foreclosure).

percent share of the national MVPD market to prove News Corp. would lack the incentive to withhold programming from competing MVPDs.[9]

As the Joint Cable Commenters have stressed from the outset, however, the principal danger in this transaction is not that News Corp. will use its programming assets to benefit its distribution business. It is, instead, that DirecTV will be used as a "weapon" to obtain supra-competitive prices for Fox programming from all retail distributors that will ultimately be borne by consumers.[10] In this regard, DirecTV's thirteen percent share is of far less significance than its presence in every local MVPD market.[11]

While News Corp. downplays what it calls "DirecTV's relatively modest market share,"[12] the fact is that DirecTV is one of the three largest MVPDs in the country.[13] More importantly, it is the chief rival to cable in virtually every local market in the nation. The transaction means that, in every local market in the country, a competing cable operator that resists price increases and carriage concessions for FOX broadcast and RSN programming will face the threat of ceding *de facto* exclusive distribution of such must-have programming to its key competitor.

Instead of confronting the consequences of this structural threat, News Corp.'s economic studies create a straw man – arguing that the merged entity would have little incentive to

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[9] *Id.* at 17.

[10] Comments of Joint Cable Commenters at 4; Reply Comments of Advance/Newhouse Communications, Cable One, Cox Communications and Insight Communications, filed July 1, 2003, at 3 ("Reply Comments of Joint Cable Commenters").

[11] Indeed, one analyst has noted that it is precisely because DirecTV has a smaller share of the retail MVPD market that it makes the most sense for News Corp. to optimize the benefits of the transaction by using DirecTV as a tool of leverage to gain price increases for Fox programming from distributors representing the other 87% of the MVPD market. Ted Hearn, *News Is Flexible On Liberty Point*, Multichannel News, April 21, 2003, at 2 (quoting SG Cowen analyst Rob Kaimowitz) ("This isn't about DirecTV. DirecTV is a weapon to force people to pick up Fox programming. DBS is a weapon against cable to shove all the programming they can make down cable's throat."); Amy C. Cosper, *The Curious Murdoch Factor*, Satellite Broadband, September 1, 2001 (quoting SG Cowen analyst Rob Kaimowitz) ("DirecTV has 10 million subscribers vs. 65 million cable customers in the United States. Murdoch will take DirecTV and use it as a battering ram against cable operators.").

[12] Opposition at 18.

[13] *See Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, Ninth Annual Report*, 17 FCC Rcd 26901 at Table B-3 (2002).

permanently withhold its programming from all rival MVPDs.[14] But that is not the argument proffered – or harm foreseen – by the Joint Cable Commenters. As Professor Rogerson demonstrates, a short-term withholding of programming from a single competing MVPD in a single market can be undertaken at little cost to, if not profitably by, News Corp. At the same time, this strategy will inflict severe damage on the affected cable operator and weaken resistance to higher prices from rival operators in all markets.[15] News Corp's opposition, however, never confronts the very real prospects for this conduct unleashed by the transaction. Nor does it address the negative impact of such conduct on consumer welfare.

News Corp. Makes Little Effort to Deny the Strategic Importance of its RSNs and FOX Broadcast Programming. News Corp. makes no real effort to deny that either its RSNs or its FOX broadcast programming constitute "must-have" content for cable operators and other MVPDs.[16] Instead, it argues that "seismic shifts in subscribership"[17] are necessary in order for the transaction to yield supra-competitive pricing opportunities for News Corp. Professor Rogerson demonstrates, however, that only a modest shift in subscribership from cable to DirecTV is necessary in any particular market in order to offset the costs of a temporary withdrawal of programming in that market – even before taking into account the increase in programming revenues from other distributors that can be gained from making an example of a hold-out cable operator in a single market.[18]

The suggestion that withholding "must-have" broadcast network and RSN programming from competing MVPDs might carry unacceptable risks to News Corp. is without merit.[19] For example, News Corp. speculates that "MVPDs that lose access to News Corp. programming could respond" by reducing prices or acquiring other programming.[20] The Commission itself has

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[14] CRA at 30-54.

[15] Rogerson at 7-21.

[16] *Cf.* Opposition at 18 (FOX broadcast programming and the Fox RSN are "undeniably very popular with viewers and widely distributed by MVPDs. Here, however, the question is not whether such programming is desirable, or even 'must have'").

[17] Opposition at 19.

[18] *See* Rogerson at 8.

[19] *See* Opposition at 22.

[20] Opposition at 22. News Corp's contention that barriers to entry are low in the regional sports programming market, *see id.*, is belied by both the dominant market share in regional sports possessed by News Corp. and recent instances of team-owned RSNs being launched or planned – and then abandoned. *See also* Rogerson at 33-36 (noting how News Corp. has failed to support its arguments to this end).

already considered and rejected similar arguments regarding "must-have" programming in the context of its decision to extend the program access rules.[21]

News Corp. concludes its perfunctory attempt to downplay the importance of its RSN and broadcast programming by repeating its misapprehension of the Joint Cable Commenters' concern with the transaction: "even using the most popular programming controlled by News Corp., attempted foreclosure would not enable DirecTV to achieve the enormous increases in subscribership or pricing that would be necessary to make such a strategy profitable."[22] Here again, the principal concern is not that News Corp.'s eventual strategy will be to inflict exclusionary harms that benefit DirecTV by blocking competing MVPDs from gaining access to programming. It is, instead, that the merged entity will use DirecTV as a negotiating weapon to inflict higher prices on cable operators – and their subscribers – for must-have Fox programming. News Corp.'s papers and studies provide no direct response to that argument.

News Corp Has Failed to Rebut the Joint Cable Commenters' Argument that the Transaction Will Enable It to Raise Prices for Its RSN and Fox Broadcast Network Programming. News Corp. states that commenters are concerned that "the transaction will give News Corp. the incentive to raise the price of RSN programming, or deny it altogether, to DirecTV's rivals in order to induce consumers to switch to DirecTV."[23] Having yet again misstated the Joint Cable Commenters' principal concern, the Applicants then proceed to demonstrate the improbability of "a scenario in which News Corp. simply refused to provide its programming to any of DirecTV's MVPD rivals"[24] – a scenario never raised by the Joint Cable Commenters. Unsurprisingly, News Corp.'s experts conclude that such a strategy is implausible because it is prohibitively expensive. The implausibility of what the Applicants call a "total

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21 *See Implementation of the Cable Television Consumer Protection And Competition Act of 1992; Development of Competition and Diversity in Video Programming Distribution: Section 628(c)(5) of the Communications Act; Sunset of Exclusive Contract Prohibition, Report and Order*, 17 FCC Rcd 12124, 12139 ¶ 33 (2002). Likewise, the argument that vertically integrated cable programmers might retaliate against a News Corp. foreclosure strategy by withholding their programming from DirecTV is of little solace to any small or medium-sized cable operator without programming assets that is engaged in a carriage dispute over Fox broadcast network and RSN programming. Opposition at 23. In addition, even if Applicants are correct that "not all subscribers are able to switch to DirecTV," News Corp. offers no evidence that the number of subscribers in any particular market in the country – let alone every market – that are technically unable to obtain service from DirecTV is of material significance. *Id.*

22 Opposition at 23.

23 *Id.* at 27.

24 *Id.* at 28.

foreclosure" strategy,[25] however, sheds little light on the bargaining leverage issues and temporary withholding identified by the Joint Cable Commenters and Professor Rogerson.

Tellingly, the Applicants repeatedly misstate the potential benefits of a carriage dispute with a cable operator as being limited to the "subscription gains to DirecTV."[26] This characterization turns the Joint Cable Commenters' concern on its head: subscriptions gains to DirecTV are simply a means of offsetting the costs to News Corp. – and increasing the costs to the affected cable operator – associated with a take-it-or-leave-it bargaining strategy for "must-have" Fox programming. The opportunity gleaned by News Corp. – and the danger posed to consumer welfare – is that the transaction tilts the status quo "balance of terror" associated with the failure of a Fox programming service and a cable operator to conclude a carriage agreement on reasonable prices and conditions. The result is that most cable operators and competing MVPDs will pay higher prices for must-have Fox programming than they otherwise would, precisely because the now-credible threat of ceding that programming to News Corp's affiliated distribution platform carries costs and risks that make acceptance of a higher price more palatable.

Further, to the extent that a handful of cable operators in a few markets seek to resist such higher prices, Professor Rogerson demonstrates that the costs to News Corp. of a temporary service interruption in any of those markets (which, of course, is a circumstance that is entirely under the control of News Corp., since it can always grant temporary signal carriage authority) can be offset partially through additional subscriber gains to DirecTV.[27] But those additional subscriber gains are simply a contingent by-product of the undue bargaining leverage accorded to News Corp. by the transaction, and not the strategic purpose animating the exercise of that leverage.

Fox's Pre-Transaction License Fees Shed No Light on Whether the Acquisition of the DirecTV Platform Provides News Corp. with a New Opportunity to Charge Supra-Competitive Prices. CRA asserts "that Fox's fees today already maximize the profits that Fox can earn on its programming."[28] This assertion is belied by recent comments from News Corp. executives themselves, which signal an intention to seek higher fees and concessions from distributors in forthcoming negotiations.[29] Moreover, Professor Rogerson indicates that CRA's assertion is not even consistent with its own theory of raising rivals' costs.[30]

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[25] *Id.* at 28.

[26] *Id.* at 27, 31.

[27] Rogerson at 15-20.

[28] CRA at 58.

[29] *See, e.g.,* Q3 2003 Fox Entertainment Group Earnings Conference Call, Fair Disclosure Wire Transcript 051303al.799, May 13, 2003 (statements of Peter Chernin, President and COO, Fox

Further, CRA's profit-maximizing supposition simply ignores the fact that "in the market for programing it is widely accepted that firms bargain over price."[31] Accordingly, the transaction presents the opportunity to extract additional rents. News Corp. will be able to threaten a cable operator with the possibility of losing RSNs and FOX broadcast programming to its strongest rival. Even if Fox's current fees "already capture whatever edge Fox programming can give one distributor over another,"[32] they do not reflect an environment in which News Corp. can seamlessly retaliate against a cable operator by initiating coordinated marketing, promotional, and packaging strategies between Fox and DirecTV to highlight the absence of the Fox service from the cable operator's lineup. Thus, regardless of whether the proposed transaction would "lower the elasticity of demand facing Fox programming" for *viewers*,[33] it dramatically raises the costs of not carrying must-have Fox programming for *distributors* – a circumstance that News Corp. undoubtedly will seek to exploit at the bargaining table.

There Is No Basis for Concluding that Eliminating the So-Called "Double Marginalization" Effect Must Offset the Competitive Harms Identified by the Joint Cable Commenters. Both Lexecon and CRA assert, but do not demonstrate, that the transaction must result in the elimination of a "double markup" for Fox programming carried by DirecTV, and thereby have a downward effect on prices paid by retail multichannel subscribers.[34] Of course, DirecTV would be under no obligation to actually pass any putative "mark-up" cost savings onto consumers. Further, News Corp.'s commitment to charge non-discriminatory prices for its programming services may discourage it from lowering prices to DirecTV in order to avoid a ripple effect vis-à-vis rates charged to other distributors. In addition, as Professor Rogerson notes, there is no basis for concluding that an impact – if any materializes – of the transaction on

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Entertainment Group) (stating that recent settlements with Time Warner and Advance Newhouse resulted in fee increases for RSNs "that we [News Corp.] feel very good about" and which "represented the kind of increase that we expected in our budget.").

30 Rogerson at 40.

31 *Id.* at 42.

32 CRA at 58.

33 *Id.*

34 *See id.* at 10-12, 16, 59-60, 63. *See also id.* at Appendix B. Professor Rogerson explains that the economics literature cited by both Lexecon and CRA does not prove that this effect dominates in most vertical mergers. Rogerson at 25-29. Indeed, the particular linear example provided by CRA fails even to shed light on the question with respect to the Applicants' own transaction. Rogerson at 29-33.

the so-called "double marginalization" effect will necessarily outweigh the raising rivals cost effect associated with this transaction.[35]

Likewise, News Corp's assertion that a uniform price increase to all MVPDs would not be profitable because of the effects on DirecTV's retail margins is unavailing.[36] Due to the integration between DirecTV, the Fox programming services, and News Corp., there are a myriad of ways in which DirecTV could be compensated for any adverse effect on its margin caused by a price increase for Fox programming service.[37] Indeed, DirecTV would end up advantaged relative to the MVPDs with which it competes, since they would lack a similar opportunity and means to be compensated for any adverse impact on their margins resulting from a price hike for an affiliated Fox programming service. Further, News Corp./DirecTV also could offset an affiliated service price hike by demanding lower carriage fees from an unaffiliated program service(s), and could back that demand with threats to drop "uncooperative" program services. News Corp.'s stable of motion picture and television studio, production and library assets make such a threat particularly credible.

There Is No Basis for Concluding that the Key Competitive Harms Associated with This Transaction Could Be Inflicted via Contract. News Corp. asserts that since it is theoretically possible for the parties to effectuate the competitive harms identified by the Joint Cable Commenters via contract, then such harms are not transaction-specific.[38] This argument is without merit. As Professor Rogerson observes, News Corp. cannot simultaneously claim that the transaction is essential to the accomplishment of all the beneficial efficiencies identified in its Application while also asserting that it is utterly unnecessary to imposing the harms identified by the Joint Cable Commenters and others.[39]

News Corp. also posits that the irrationality of exclusive agreements that foreclose competing MVPDs is demonstrated by "the fact that News Corp. and DirecTV have not entered into" such agreements to date.[40] But the absence of such agreements demonstrates only a misalignment between DirecTV and News Corp.'s pre-transaction incentives which disappears once the DirecTV acquisition is consummated. As Professor Rogerson points out:

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[35] Rogerson at 29.

[36] Opposition at 33-34.

[37] *See* Rogerson at 12.

[38] Opposition at 24-26.

[39] Rogerson at 23.

[40] Opposition at 26.

> [to] the extent that raising rivals' costs would involve almost any type of activity *other than the permanent withdrawal of programming* . . . it seems beyond doubt that News Corp. and DirecTV could better manage and coordinate . . . from within the boundaries of the firm.[41]

Indeed, since the Joint Cable Commenters believe News Corp.'s ultimate interest is to use DirecTV as a tool to force higher program prices across the spectrum of all MVPDs, there may be no efficient or practical means of fashioning a contract to effectuate that result.

The simple fact is that the transaction enables News Corp. to coordinate program carriage negotiations for Fox content and DirecTV marketing campaigns in a manner designed to maximize pressure on hold-out cable operators resisting price increases for Fox programming. While such conduct depended upon the voluntary consent of two independent entities prior to the transaction – and carried the risk that contracts memorializing such conduct could create antitrust exposure – acquiring control of DirecTV allows News Corp. to compel such conduct, without the risk that one entity may be hesitant or uncooperative.

The Issues Raised by the Joint Cable Commenters Are Transaction-Specific. The Joint Cable Commenters have pointed out that News Corp.'s controlling interest in DirecTV will increase the costs of retransmission consent to MPVDs for News Corp. owned and operated television stations.[42] News Corp. not surprisingly uses retransmission consent negotiations as an opportunity to leverage its "must have" local broadcast programming, which includes exclusive sports content, in order to gain carriage and compensation for other News Corp. programming. Following its takeover of DirecTV, News Corp. will have the ability to use the threat of even short-term withdrawals of local Fox programming to extract price concessions from distributors, as well as divert subscribers away from rival MVPDs to DirecTV. The Joint Cable Commenters have also shown how the transaction will increase News Corp.'s incentive and ability to raise the price of valuable sports programming content.[43] News Corp. already controls a vast amount of "must-have" regional sports programming. Control over such programming has been critical to the growth and maintenance of News Corp.'s dominant position in other video programming markets around the world.

The fact that such issues may touch upon generic concerns regarding retransmission consent and sports programming costs is of no moment,[44] since it is the DirecTV acquisition itself that increases News Corp.'s incentive and ability to wield undue pricing power and

41 Rogerson at 22-23 (emphasis supplied).

42 Comments of Joint Cable Commenters at 29-34.

43 *Id.* at 41-44.

44 *Cf.* Opposition at 10.

bargaining leverage in connection with the distribution of its broadcast stations and RSNs.[45] Indeed, the Commission has expressly recognized that it has an obligation in a license transfer proceeding to "to decide the issues presented by that case,"[46] even if such issues implicate generic policy concerns that are the subject of an ongoing rulemaking proceeding.

Moreover, in this instance there no ongoing rulemaking proceeding that addresses the issues raised by the Joint Cable Commenters. Indeed, no other entity has ever owned and operated the unique combination of broadcast network, local stations, cable programming, and multichannel distribution assets involved in this transaction.[47] It is the very singularity of the asset combination involved here that triggers the competitive and consumer harms raised by the Joint Cable Commenters and others in connection with this transaction.

The Commission's Retransmission Consent and Program Access Rules Provide No Protection Against News Corp.'s Efforts to Leverage DirecTV to Obtain Higher Prices and

[45] *See* Comments of Joint Cable Commenters at 41-44.

[46] *In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations by Time Warner Inc. and America Online, Inc., Transferors, to AOL Time Warner Inc., Transferee, Memorandum Opinion and Order*, 16 FCC Rcd 6547, 6550-51 ¶7 (2001) (citing *Policies and Rules for Alternative Incentive Based Regulation of Comsat Corp.*, IB Docket No. 98-60, *Report and Order*, 14 FCC Rcd 3065, 3079 ¶ 38 (1999) and *SEC v. Chenery Corp.*, 332 U.S. 194, 201-03 (1947)).

[47] The Commission's 1999 review of News Corp's acquisition of a non-controlling interest in then-nascent EchoStar hardly suffices to dispose of the concerns raised with News Corp.'s present attempt to assume control over well-established DirecTV. *Cf.* Opposition at 7. Furthermore, DBS operators were not authorized to offer local-into-local service at the time of the EchoStar deal, so that transaction did not raise the same set of issues as the present one does. In addition, News Corp. did not acquire control over Liberty's half of Fox Sports until just a few weeks before the Commission issued its Order in the EchoStar proceeding, *see News Corp. Buys Liberty Media's Half Of Fox Sports Venture*, Warren's Cable Regulation Monitor, April 12, 1999, so the issue of undue pricing power and bargaining leverage in connection with control of the majority of local professional sports programming on regional sports networks was hardly prominent then. Finally, EchoStar had far fewer subscribers than does DirecTV in the instant transaction, *see Application of MCI*, 16 FCC Rcd 21608, 21615, ¶ 14 (1999) (estimating EchoStar's size at 1.4 million subscribers), and was not among the top 10 MVPDs in the country during the pendency of the proceeding. *See Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, Fifth Annual Report*, 13 FCC Rcd 24284 at Table C-3 (1998). By contrast, DirecTV has over 11 million subscribers and is larger than all but the largest cable company in the country. *See* SkyREPORT, "National DTH Counts," available at http://www.skyreport.com/dth_ counts.cfm (as of March, 2003, DirecTV serves 11,420,000 subscribers).

More Concessions as a Condition for Carrying Fox RSNs and Broadcast Stations. Applicants err by suggesting that the Commission's good-faith negotiation rules would prevent News Corp. from leveraging its affiliated multichannel distribution platform during retransmission consent negotiations to extract higher prices.[48] Indeed, the rules do not even contemplate such a circumstance, since they were promulgated at a time in which same market broadcast station/multichannel distribution platform combinations were either unlawful or wholly impracticable.[49] In addition, the rules themselves do not preclude a broadcast station from according differential – or even discriminatory – treatment among MVPDs in the same market.

Indeed, News Corp's conspicuous refusal to subject its owned and operated Fox broadcast stations to its program access commitments – including the non-discrimination requirement – heighten concerns that it will seek to unfairly leverage its same market MVPD/broadcast station combinations in an anti-competitive manner. Further, the prohibition against exclusive retransmission consent agreements sunset on December 31, 2005, before the next election cycle goes into effect.[50] In short, there is no basis for concluding that the existing good-faith retransmission consent negotiation rules can prevent the transaction-specific harms to consumer welfare identified by the Joint Cable Commenters.[51]

Likewise, contrary to Applicants' assertions, the program access rules do not preclude News Corp. from charging an inflated price to DirecTV for must-have Fox programming, and then using that inflated price as the "non-discriminatory" benchmark for the rates demanded from other MVPDs.[52] Indeed, this transaction raises a particular risk of such conduct since, in contrast to cable programmers vertically integrated with a cable operator, DirecTV's presence in every local market obviates the involvement of unaffiliated MVPDs in the establishment of a benchmark price for a programming service.[53]

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[48] Opposition at 44-47, 61.

[49] *See* Comments of the Joint Cable Commenters at 18 n.31.

[50] 47 C.F.R. § 76.64(l).

[51] In response to recent questioning before the Senate antitrust subcommittee, Rupert Murdoch stated that requiring Fox O&Os to charge MSOs the same fees as they charge DirecTV was "a reasonable request." However, he rebuffed suggestions that he extend full program access and nondiscrimination provisions to Fox O&Os and RSNs on the grounds that, when negotiating with MSOs, "we're not dealing with a bunch of virgins here." *See, e.g., On The Hill*, Cablefax, June 19, 2003. Mr. Murdoch's resistance to making a simple nondiscrimination commitment with regard to retransmission consent is telling.

[52] Opposition at 60-61

[53] Comments of the Joint Cable Commenters at 58.

News Corp.'s "Structural Checks" Will Not Deter the Competitive Harms Identified by the Joint Cable Commenters. News Corp. repeats its assertion that an independent audit committee composed of outside directors will be able to detect and deter affiliated transactions that benefit Fox programming services to the detriment of DirecTV, and attaches an affidavit from Professor Lawrence Hammermesh in support of this assertion.[54] The credibility of this assertion, however, is undermined by News Corp's own admission that the Audit Committee is under no obligation to review any particular transaction between Fox programming services and DirecTV.[55] Further, while the Audit Committee is empowered to hire outside counsel and consultants to compensate for its lack of subject matter expertise, it is, once again, under no obligation to do so and may face practical constraints – such as timing considerations – that militate against taking such a step. In addition, News Corp. never addresses how and on what basis the Audit Committee is supposed to invalidate a programming contract between DirecTV and a Fox programming service if, as almost certainly will be the case given the size of DirecTV's subscriber base, the contract specifies a license fee that is lower than that paid by virtually every other MVPD in the country.

News Corp. Has Failed to Allay Concerns that the Transaction Will Enable it to Use its Control over the Dominant Provider of Electronic Programming Guides to Harm Competition and Consumers. In their initial comments, the Joint Cable Commenters pointed out how this transaction has the potential to expand opportunities for News Corp. to use its control over Gemstar/TV Guide in ways that harm consumers. While News Corp. seeks to dismiss these concerns by asserting that they are not transaction-specific, the DirecTV acquisition threatens to give new impetus to anti-competitive leveraging of Gemstar/TV Guide's dominance in the EPG marketplace.[56]

For example, News Corp. could utilize its control over Gemstar/TV Guide to benefit DirecTV and Fox in circumstances in which an affiliated News Corp. programming service is involved in a carriage dispute with a cable operator.[57] News Corp. could also amend or modify Gemstar/TV Guide's licensing agreement to retaliate against cable operators unwilling to acquiesce to fee and carriage demands sought for News Corp. programming services.

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[54] *See* Affidavit of Lawrence A. Hammermesch, Exhibit C to the Opposition.

[55] Opposition at 55. Indeed, nothing News Corp. has said demonstrates how the Hughes corporate structure would safeguard against price increases of the type Professor Rogerson believes are likely. Indeed, none of Professor Rogerson's concerns "depend in any way on the assumption that News Corp. will be able to take advantage of the outside shareholders of DirecTV." Rogerson at 13, n.16.

[56] Opposition at 50-51.

[57] *See* Center For Digital Democracy *ex parte* submission, July 27, 2003 (discussing potential for News Corp. to use its Gemstar subsidiary to gain unfair advantage over rivals).

News Corp's control over Gemstar/TV Guide already provides it with excessive control over the "look and feel" of cable operators' key day-to-day interface with their subscribers. The acquisition of DirecTV provides News Corp. with a new incentive to wield that control in a manner that disadvantages cable operators and favors DirecTV. Further, Gemstar's aggressive claims to hold exclusive patents covering virtually all EPG characteristics and features have inhibited the development of competition in the electronic programming guide marketplace, thereby hampering cable operators from developing an EPG free of interference from Gemstar. The instant transaction provides a clear set of new incentives and opportunities for News Corp. to use the power asserted by Gemstar/TV Guide to reduce output and inhibit competition.

CONCLUSION

As Professor Rogerson reaffirms:

> News Corp.'s takeover of DirecTV will harm consumers because it will provide News Corp. with both an increased incentive and an increased ability to raise the prices that it charges rival MVPDs for programming. These price increases will be passed through to consumers. While it may not turn out to be generally profitable for News Corp. to permanently withdraw its programming from rival MVPDs after it acquires control of DirecTV, the revenue that News Corp. would lose from withdrawing programming from rival MVPDs will be at least partially offset by the profits that News Corp. would earn from subscribers that switch to DirecTV. This will make the threat of withdrawing programming more credible and thus allow News Corp. to bargain for higher prices. Furthermore, temporary withdrawals of programming are very likely to be profitable for News Corp. after it acquires control of DirecTV. These temporary withdrawals will directly harm consumers and will also provide News Corp. with even more bargaining leverage in its negotiations over programming prices with rival MVPDs.[58]

Respectfully submitted,

Bruce Sokler

Bruce D. Sokler

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[58] Rogerson at 43-44.

cc: Chairman Michael K. Powell
Commissioner Kathleen Q. Abernathy
Commissioner Jonathan S. Adelstein
Commissioner Michael J. Copps
Commissioner Kevin J. Martin
Simon Wilkie
W. Kenneth Ferree
Deborah E. Klein
Marcia Glauberman
Barbara Esbin
James Bird
JoAnn Lucanik
Neil Dellar
Douglas Webbink
Tracy Waldon
James H. Barker
Bertram W. Carp
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Lawrence W. Secrest III
Todd M. Stansbury
Richard E. Wiley
William M. Wiltshire
Qualex International

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of:	)	
	)	
General Motors Corporation, Hughes	)	
Electronics Corporation, and the	)	
News Corporation Limited	)	MB Docket No. 03-124
Application To Transfer Control Of FCC	)	
Authorizations And Licenses Held By	)	
Hughes Electronics Corporation	)	
To The News Corporation Limited	)	

A FURTHER ECONOMIC ANALYSIS OF THE NEWS CORP. TAKEOVER OF DIRECTV

William P. Rogerson
Professor of Economics
Northwestern University

Dated: August 4, 2003

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A FURTHER ECONOMIC ANALYSIS
OF THE NEWS CORP. TAKEOVER OF DIRECTV

My name is William P. Rogerson. I am a professor of economics at Northwestern University. I prepared an analysis of the transaction in this proceeding for the Joint Cable Commenters.[1] Along with their Reply Comments,[2] the parties to the transaction have submitted economic studies by Lexecon and by Charles River Associates.[3] I have reviewed those studies carefully. In my view they do not refute the concerns I expressed regarding the transaction.

Everything in this Analysis is derivable from the Public Version of the CRA Report. To

1 William P. Rogerson, *An Economic Analysis of the Competitive Effects of the Takeover of DirecTV by News Corp.*, MB Docket No. 03-124, June 16, 2003 (*"Rogerson Affidavit").*

2 *Opposition to Petitions to Deny and Reply Comments,* MB Docket No 03-124, July 1, 2003 (*"News Corp. Reply Comments*").

3 Dennis W. Carlton, Janice H. Halpern and Gustavo E. Bamburger, Lexecon Inc., *Economic Analysis of the News Corporation/DirecTV Transaction,* July 1, 2003, *"Lexecon Report,"* and Steven C. Salop, Carl Shapiro, David Majerus, Serge Moresi, and E. Jane Murdoch, Charles River Associates, *News Corporation's Partial Acquisition of DirecTV: Economic Analysis of Vertical Foreclosure Claims,* July 1, 2003, *"CRA Report."*

reaffirm that conclusion, I provided the public version of the CRA Report, my first Affidavit, and a complete draft of this Analysis to a reputable, independent economist. He was able to replicate, from the public versions, the calculations in this Analysis that refer to the CRA report.

INTRODUCTION

In my initial Affidavit, I concluded that the acquisition of a controlling stake in DirecTV by News Corp. could provide News Corp both the ability and the incentive to raise prices to rival MVPDs for its "must have" programming – its regional sports networks and its owned-and-operated television broadcast stations.[4] The acquisition of DirecTV will increase News Corp.'s bargaining power and negotiating leverage and will lead to higher prices for consumers, particularly in less dense regions of the country served by small to medium sized cable systems.

In large part, the studies of News Corp.'s economists are focused upon demonstrating that it is not economically rational for News Corp to withhold programming permanently from rival MVPDs to increase DirecTV's attractiveness and market share. Lexecon and CRA ignore and do not account for the more likely scenario – that News Corp., armed with increased bargaining power, has increased ability to raise prices to all distributors, and therefore to consumers, through the actual or threatened withholding of programming. Furthermore, Lexecon and CRA ignore the fact that engaging in or threatening to engage in temporary withdrawals of programming during pricing disputes may provide an even more powerful lever for News Corp. than the threat of permanently withdrawing programming.

However, the quantitative exercise that CRA undertook does provide the components that permit me to demonstrate that this transaction will increase News Corp.'s ability to bargain with

4 *See Rogerson Affidavit* at 17 ("News Corp will be able to charge higher prices because the merger will increase its bargaining power with MVPDs.").

rival MVPDs for higher programming prices. Even for the case of permanent withdrawals considered by CRA, the profits that DirecTV would earn if News Corp. withdrew programming from its rivals would offset a significant share of News Corp's losses. This is sufficient to significantly increase the credibility of News Corp.'s threat to withdraw programming. Furthermore, the CRA math can also be used to calculate the profitability of temporary withdrawals of programming during price disputes. I calculate that if News Corp. temporarily withholds an RSN or a broadcast station from a targeted MPVD, it economically breaks even if less than one percent of the MVPD's subscribers migrate to DirecTV. Once one additionally realizes that the purpose of the temporary withholding of programming would be also, if not primarily, to increase prices across a national base of over ninety million MPVD homes, it becomes clear that, contrary to the parties' economic reports, News Corp. has every incentive to engage in such conduct.

My affidavit is organized as follows:

First, I briefly restate the economic theory outlined in my initial affidavit explaining why the transaction will provide News Corp. with the *ability* to bargain for higher programming prices and carefully re-explain why this is a different theory than the standard raising rivals' costs theory that is the sole focus of News Corp.'s economic experts. In Appendix A, I present a standard analysis of the bargaining problem between a seller and buyer and explain how it can be interpreted to apply to the bargaining problem between News Corp. and a rival MVPD.

Next, I consider the arguments made by News Corp.'s economic experts and explain the flaws and problems with each of them. In particular, I explain why the merger will increase News Corp.'s ability to bargain for higher prices even if it does not turn out to be profitable for

News Corp. to completely and permanently withhold programming. I use CRA's own non-confidential data and calculations to quantitatively assess the impact of the merger and show that the impact will be significant. I address several remaining points before making a brief conclusion.

I. THIS TRANSACTION INCREASES NEWS CORP.'S *ABILITY* TO BARGAIN FOR HIGHER PROGRAMMING PRICES

In my initial Affidavit analyzing the competitive effects of the takeover of DirecTV by News Corp., I identified two different economic theories of harm that should be considered. First, I explained how the transaction would increase News Corp.'s ability to bargain for higher programming prices in its negotiations with MVPDs and therefore increase its *ability* to raise prices for programming. Second, following a more standard "raising rivals' costs" model,[5] I explained how this transaction would increase News Corp.'s *incentive* to raise prices because News Corp. would internalize some of the benefit that DirecTV would receive were News Corp. to raise programming prices to its rivals. News Corp. and its economists address the second theory and ignore the first.

Standard "raising rivals' costs" models are based on the assumption that the upstream input supplier has *all of the pricing power* in the input market. In other words, the upstream input supplier is able to make a take-it-or-leave-it price offer to downstream users. As a result, the upstream input supplier is able to charge any price it wishes – subject only to the constraint

5 *See, e.g.,* Michael H. Riordan and Steven Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 Antitrust L.J. 513(1995); Thomas G. Krattenmaker and Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 Yale L.J. 209 (1986); and Janusz A. Ordover, Garth Saloner, and Steven C. Salop, *Equilibrium Vertical Foreclosure,* 80 American Economic Review (1990).

that the downstream firm would be better off accepting the price than doing without the product entirely. The "raising rivals' costs" literature calculates the optimal price for the upstream input supplier to announce in this situation and then investigates how vertical integration will affect this optimal price. CRA present an algebraic example employing this type of analysis in Appendix B of its report.

Although the foregoing assumptions may be relatively correct in other markets, when I began to study this particular transaction it became clear to me that such a model could not capture the essential concern being expressed by many market participants here. In particular, market observers believe this transaction will increase News Corp.'s bargaining power and thus give it the *ability* to charge higher prices.[6]

In my initial Affidavit I showed that the validity of these concerns could be supported by standard economic reasoning. In particular, when one assumes that the input price is determined by bilateral bargaining between the upstream and downstream firm, and uses standard economic models of bargaining to explain how the price that the upstream firm is able to charge the downstream firm is determined, there is a fairly simple, intuitive and robust economic reason to expect that one effect of a vertical merger will be to allow the upstream firm to increase the price it charges to rival downstream firms.[7] The basic idea is simply that when News Corp. is vertically integrated with DirecTV, its threat to withhold programming from rival MVPDs will be more credible because the loss in programming revenue that News Corp. would experience

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6 *See Rogerson Affidavit* at 23-24.

7 As in the standard raising rival's cost literature, a vertical merger also generally has a reduced double marginalization effect which tends to reduce prices to consumers and examples can be created where either effect dominates. I argue *infra* Section III.B that neither CRA nor Lexecon have demonstrated that the reduced double marginalization effect is likely to outweigh

from withholding the programming will be offset to some extent by the increase in profits that DirecTV would earn when its rivals no longer offer the programming.[8]

To explain the bargaining problem between News Corp. and a rival MVPD, I present a standard analysis of the bargaining problem between a seller and buyer in Appendix A of this paper. Appendix A considers a fairly general bargaining framework that allows for outcomes intermediate between the two polar extremes where either the seller is allowed to make a take-it-or-leave-it offer to the buyer or the buyer is allowed to make a take-it-or-leave-it offer to the seller. In every case -- except for the polar extreme case where it is assumed that the seller is able to make a take-it-or-leave-it offer to the buyer (which is of course the case considered by the raising rivals' costs literature) -- the seller is able to negotiate a higher price when his "threat point profit" increases.

The expert reports that News Corp. has commissioned are seriously incomplete because they consider *only* the second standard "raising rivals' costs" theory of harm and are *completely silent* on the first theory of harm that I advanced. News Corp.'s experts focus exclusively on News Corp.'s *incentive* to raise prices. As best I can tell, they do not even acknowledge that they are aware that I advance a completely separate theory explaining why this transaction has the potential to raise prices. They have simply failed to dispute that controlling DirecTV will increase News Corp.'s bargaining power and its concomitant *ability* to bargain for higher prices.

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the competitive harms in the case of this particular merger.

[8] Standard economic models of bilateral bargaining (*see* for example, John C. Harsanyi, *Bargaining* in The New Palgrave Game Theory, W.W. Norton (1989); Alvin Roth, *Axiomatic Models of Bargaining*, Springer-Verlag (1979) predict that an agent will do better in bargaining when its "threat point profit" (*i.e.*, the profit that the agent would earn if an agreement is not reached) is higher. *See also* Appendix A of this Affidavit.